Trademark and Bankruptcy Advisory: Running on Empty...Trademarks And Bankruptcy

10/1/2009

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Neither trademark practitioners nor trademark owners or users can afford to operate without deference to bankruptcy law principles. Many companies that owned and operated under high–profile trademarks for decades have recently filed for bankruptcy, and with the business and goodwill of these companies go their trademarks. Since trademarks are often one of the most valuable assets a company may own, their disposition in a bankruptcy proceeding is of paramount importance.

Trademarks and Licenses

The Lanham Act, which codifies federal trademark law, does not discuss the issue of bankruptcy. Similarly, trademarks are excluded from specific mention in the U.S. Bankruptcy Code. Nevertheless, there is no question that trademarks, as well as trademark licenses and related agreements, are considered property of a bankrupt estate subject to the control and jurisdiction of the bankruptcy court in a bankruptcy case. A license or a contract which has been terminated prior to the filing of a bankruptcy petition will not be deemed property of the bankrupt estate. However, all conditions for termination, including the expiration of any cure period, generally must have occurred prior to the bankruptcy filing if the license or contract is to be excluded from disposition in the bankruptcy case. License provisions for termination of the license upon the commencement of a bankruptcy case will be ineffective since the condition for termination will not have occurred prior to bankruptcy filing, and bankruptcy law does not permit the enforcement of such "*ipso facto*" provisions.

Trademark Infringement

Under the Bankruptcy Code, there are automatic stay provisions which can be very pivotal in the trademark context. These provisions stay the filing or the continuation of an infringement action against a bankrupt debtor after a bankruptcy petition has been filed, and also stay the issuance of any injunctive relief outside the bankruptcy court. In certain instances, a non-debtor party might be permitted to seek relief from a stay and to obtain preliminary injunctive relief against trademark infringement in bankruptcy court if no monetary damages are requested. However, preliminary injunctive relief against a debtor is often viewed as disruptive to reorganization efforts and not in the best interests of the estate.

While bankruptcy law seeks to balance the interests of debtors and creditors, it does provide breathing room for a debtor to either liquidate its business, in whole or in part, or to reorganize its business under an accepted plan. A reorganized debtor is provided a fresh start, often after reducing its financial liabilities significantly and by discharging its pre-bankruptcy obligations. Liability for trademark infringement, generally, is no exception, and a discharge of that financial obligation is possible.

Executory Contracts

Another facet of bankruptcy law which directly affects trademarks, and is often in conflict with trademark law principles, is the assumption or rejection of executory contracts. An executory contract is an agreement where there is performance remaining due by each party, other than merely the payment of money. Under the Bankruptcy Code, a debtor has the option, within certain limitations, to assume or reject any executory contract. This is to allow the debtor to maximize the value of the estate, by rejecting burdensome contracts, while assuming beneficial ones. Trademark licenses have been held consistently to be executory contracts. If the license has not terminated prior to the filing of the bankruptcy petition, it will be deemed executory and subject to the automatic stay provisions of the Bankruptcy Code. Thus, once a bankruptcy petition has been filed, a trademark license or related contract cannot be terminated or otherwise revoked, by either party, without approval of the bankruptcy court.

The treatment of executory contracts in bankruptcy can be a severe hardship on a trademark owner, whether debtor or non-debtor. Bankruptcy law offers little protection to a non-debtor trademark owner because although trademark law requires a licensor to control the use and quality of the goods and/or services provided by the licensee under the licensed mark, the automatic stay provisions of bankruptcy law and the inability to terminate an executory license prevent a licensor from taking any action unilaterally against a debtor licensee. Trademark owners must control the use of their marks because it is the underlying public policy interest of trademark law that consumers are entitled to expect a certain level of quality in the goods and/or services which are provided under a particular mark. A trademark licensor's penalty for failing to serve the public in this fashion is forfeiture of all its legal rights to the mark. However, when a licensee files a bankruptcy petition, public policy concerns may be subordinated to the effort to save a licensee debtor. Since the failure to monitor the use and quality of a licensed mark can result in a licensor's loss of rights in the mark, its failure to take action could jeopardize the non-debtor's rights in its intangible assets. In a situation like this, a licensor may ask for relief from the automatic stay in an effort not only to protect the public's expectations but also to protect its trademark and the goodwill associated with it.

When the Debtor Is the Licensor

If the debtor is the licensor, a different set of problems may exist. Despite having filed a bankruptcy petition, a debtor-licensor must continue to control its licensee's use of the licensed mark, which might be difficult to accomplish if the cost is high. If the debtor is the licensor, the severity of a licensor's rejection of a trademark license is a very real problem for a trademark licensee. The protection afforded to licensees of other forms of intellectual property in the

Bankruptcy Code does not extend to trademarks. Thus, if a licensor rejects an executory contract/license, it could be ruinous to a non-debtor licensee who will lose all rights to continue to use the licensed mark. The licensee's recourse upon rejection is to file an unsecured claim for damages suffered as a result of the rejection.

The filing of bankruptcy does not automatically result in a debtor's abandonment of its rights in its marks. However, a trustee or a debtor-in-possession should protect such marks from abandonment or loss of value by continuing to use them or through their sale. When all of the assets of a bankrupt debtor are sold intact to a single purchaser, the trademarks will be included in such sale and, thus, all of the assets and the goodwill of the company, including the trademarks, will move together. However, it is not uncommon for a debtor's assets to be sold piecemeal, and this is when difficulties may arise. Under trademark law, the sale or assignment of a trademark is not valid unless the transfer includes the goodwill of the business in which the mark is used. Thus, in the context of a bankruptcy case, it is necessary that a sufficient portion of the business be sold with the trademark in order to ensure that the requisite goodwill has passed with the sale. There is no standard for what is "enough," and often the purchasing party will acquire and rely only upon the residual "goodwill" in the mark that continues to exist.

Purchasing Trademarks in Bankruptcy

Purchases of trademarks in bankruptcy by unaffiliated third parties have the potential to create consumer perception problems. Many very famous trademarks have recently been purchased from bankrupt estates, and some of the purchasing entities are now selling products under these various marks. If the products being provided under these trademarks are not the same as the original products sold under the marks, or have different ingredients, or are of a different level of quality than were the products provided by the bankrupt debtor, this could be viewed as consumer deception, which violates the principles of trademark law. Thus, purchasers of marks out of bankruptcy must be careful in how such marks are used. In addition, these new owners must be certain not to misrepresent their status, and must not lead consumers to believe that they are the prior or original trademark owner when, in fact, they are not.

The competing interests of the U.S. Bankruptcy Code and trademark law often lead to chaos in the handling of trademarks and trademark licenses in a bankruptcy proceeding. Thus, it is crucial to prepare in advance for and to proceed with caution in a bankruptcy.

For more information on or assistance with this or any other trademark matter, please contact one of the attorneys listed below or the Mintz Levin attorney who ordinarily handles your legal affairs.

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